



Senate

File No. 777

General Assembly

January Session, 2001

(Reprint of File No. 192)

Substitute Senate Bill No. 1052
As Amended by House Amendment
Schedule "A"

Approved by the Legislative Commissioner
May 18, 2001

AN ACT CONCERNING THE PRINCIPAL AND INCOME ACT.

Be it enacted by the Senate and House of Representatives in General Assembly convened:

1 Section 1. (NEW) (a) A court shall not change a fiduciary's decision
2 to exercise a discretionary power conferred by sections 45a-542 to 45a-
3 542ff, inclusive, of the general statutes unless it determines that the
4 decision was an abuse of the fiduciary's discretion. A court shall not
5 determine that a fiduciary abused its discretion merely because the
6 court would have exercised the discretion in a different manner or
7 would not have exercised the discretion.

8 (b) The decisions to which subsection (a) of this section applies
9 include: (1) A determination under subsection (a) of section 45a-542c of
10 the general statutes of whether and to what extent an amount should
11 be transferred from principal to income or from income to principal;
12 and (2) a determination of the factors that are relevant to the trust and
13 its beneficiaries, the extent to which they are relevant, and the weight,
14 if any, to be given to the relevant factors, in deciding whether and to
15 what extent to exercise the power conferred by subsection (a) of

16 section 45a-542c of the general statutes.

17 (c) If a court determines that a fiduciary has abused its discretion,
18 the remedy is to restore the income and remainder beneficiaries to the
19 positions they would have occupied if the fiduciary had not abused its
20 discretion, according to the following rules: (1) To the extent that the
21 abuse of discretion has resulted in no distribution to a beneficiary or a
22 distribution that is too small, the court may require the fiduciary to
23 distribute from the trust to the beneficiary an amount that the court
24 determines will restore the beneficiary, in whole or in part, to his or
25 her appropriate position; (2) to the extent that the abuse of discretion
26 has resulted in a distribution to a beneficiary that is too large, the court
27 may restore the beneficiaries, the trust, or both, in whole or in part, to
28 their appropriate positions by requiring the fiduciary to withhold an
29 amount from one or more future distributions to the beneficiary who
30 received the distribution that was too large or requiring the beneficiary
31 to return some or all of the distribution to the trust; and (3) to the
32 extent that the court is unable, after applying subdivisions (1) and (2)
33 of this subsection, to restore the beneficiaries, the trust, or both, to the
34 positions they would have occupied if the fiduciary had not abused its
35 discretion, the court may require the fiduciary to pay an appropriate
36 amount from its own funds to one or more of the beneficiaries or to the
37 trust, or both.

38 (d) Upon a petition by the fiduciary, the court having jurisdiction
39 over the trust or estate may determine whether a proposed exercise or
40 nonexercise by a fiduciary of a discretionary power conferred by
41 sections 45a-542 to 45a-542ff, inclusive, of the general statutes will
42 result in the abuse of the fiduciary's discretion. If the petition describes
43 the proposed exercise or nonexercise of the power and contains
44 sufficient information to inform the beneficiaries of the reasons for the
45 proposal, the facts upon which the fiduciary relies, and an explanation
46 of how the income and remainder beneficiaries will be affected by the
47 exercise or nonexercise of the power, a beneficiary who challenges the
48 proposed exercise or nonexercise has the burden of establishing that it
49 will result in an abuse of discretion.

50 Sec. 2. Subsection (c) of section 45a-542c of the general statutes is
51 repealed and the following is substituted in lieu thereof:

52 (c) A trustee may not make an adjustment:

53 (1) That diminishes the income interest in a trust that requires all of
54 the income to be paid at least annually to a spouse and for which an
55 estate tax or gift tax marital deduction would be allowed, in whole or
56 in part, if the trustee did not have the power to make the adjustment;

57 (2) That reduces the actuarial value of the income interest in a trust
58 to which a person transfers property with the intent to qualify for a gift
59 tax exclusion;

60 (3) That changes the amount payable to a beneficiary as a fixed
61 annuity or a fixed fraction of the value of the trust assets;

62 (4) From any amount that is permanently set aside for charitable
63 purposes under a will or the terms of a trust unless both income and
64 principal are so set aside;

65 (5) If possessing or exercising the power to make an adjustment
66 causes an individual to be treated as the owner of all or part of the
67 trust for income tax purposes and the individual would not be treated
68 as the owner if the trustee did not possess the power to make an
69 adjustment;

70 (6) If possessing or exercising the power to make an adjustment
71 causes all or part of the trust assets to be included for estate tax
72 purposes in the estate of an individual who has the power to remove a
73 trustee or appoint a trustee, or both, and the assets would not be
74 included in the estate of the individual if the trustee did not possess
75 the power to make an adjustment;

76 (7) If the trustee is a beneficiary of the trust;

77 (8) If the trustee is not a beneficiary, but the adjustment would
78 benefit the trustee directly or indirectly;

- 79 (9) Between the income and principal of a legal life estate; or
- 80 (10) If the exercise of the power to adjust by allocating principal to
81 income conferred by subsection (a) of this section would not
82 significantly increase the funds actually available to the income
83 beneficiary, taking into account funds available from sources other
84 than the trust.

The following fiscal impact statement and bill analysis are prepared for the benefit of members of the General Assembly, solely for the purpose of information, summarization, and explanation, and do not represent the intent of the General Assembly or either House thereof for any purpose:

OFA Fiscal Note

State Impact: None

Affected Agencies: Probate Court (Judicial Department)

Municipal Impact: None

Explanation**State Impact:**

While the bill as amended clarifies certain rules regarding the authority of the court and the obligations of fiduciaries administering trusts, it is not anticipated that passage would result in any fiscal impact to the Probate Court Administration Fund (PCAF). All probate court expenditures are paid for from the PCAF, which is a non-General Fund account.

House "A" makes a technical change and would not result in any additional fiscal impact.

OLR Amended Bill Analysis

sSB 1052 (as amended by House "A")*

AN ACT CONCERNING THE PRINCIPAL AND INCOME ACT.**SUMMARY:**

This bill makes certain changes relating to fiduciary decisions under the Connecticut Principal and Income Act (CPIA), which establishes certain rules for fiduciaries administering trusts. The rules relate to allocating property between principal and income and between income and remainder beneficiaries (income beneficiaries generally receive funds during the life of a trust and remainder beneficiaries receive the remainder of a trust's funds when it terminates). CPIA gives fiduciaries certain discretionary powers including the power to adjust between principal and income under certain circumstances.

The bill prohibits a court from changing a fiduciary's decision to exercise a discretionary power under the CPIA unless the decision was an abuse of the fiduciary's discretion. It prohibits a court from finding an abuse of discretion merely because the court would have exercised the discretion in a different manner or not exercised the discretion.

The bill applies to fiduciary decisions including:

1. whether and to what extent to transfer an amount between principal and income under the trustee's power to adjust; and
2. determinations of which factors are relevant to the trust and its beneficiaries, the extent that the factors are relevant, and the weight (if any) given to them when deciding whether and to what extent to exercise the power to adjust.

The bill provides rules for the court to remedy a fiduciary's abuse of discretion and a procedure for a fiduciary to petition the court for a determination whether a proposed exercise or non-exercise of discretion would be an abuse of discretion.

Current law prohibits a trustee from using his power to adjust if it would not significantly increase the funds actually available to the income beneficiary (accounting for funds available from sources other than the trust). The bill limits this restriction to adjustments allocating principal to income.

*House Amendment "A" adds the restriction of the trustee's power to adjust.

EFFECTIVE DATE: October 1, 2001

REMEDIES

Under the bill, if the court finds that a fiduciary abused his discretion, it can restore the income and remainder beneficiaries to the position they would have been in if not for the fiduciary's abuse of discretion.

The bill provides the following rules.

1. If a beneficiary did not receive a distribution or received one that was too small because of the fiduciary's abuse of discretion, the court can require the fiduciary to distribute from the trust an amount that will restore the beneficiary in whole or part to his appropriate position.
2. If a beneficiary received a distribution that was too large, the court can require the fiduciary to withhold an amount from future distributions or require the beneficiary to return some or all of the distribution to the trust in order to restore beneficiaries, the trust, or both to their appropriate positions.
3. When the court cannot restore beneficiaries, the trust, or both to the position they would have been in if not for the fiduciary's abuse of discretion, the court can require the fiduciary to pay beneficiaries, the trust, or both from its own funds.

FIDUCIARY REQUESTS TO COURTS

The bill allows a fiduciary to petition the court that has jurisdiction over a particular trust or estate for a determination whether a proposed exercise or non-exercise of a discretionary power would be an abuse of discretion.

The bill places the burden of showing that the fiduciary's proposal will be an abuse of discretion on a beneficiary who challenges it if the fiduciary's petition has enough information to inform the beneficiaries of (1) the reasons for the proposal, (2) the facts that the fiduciary relies on, and (3) how the income and remainder beneficiaries will be affected.

BACKGROUND

Fiduciaries and the Power to Adjust under the CPIA

Under the CPIA, a fiduciary exercising the power to adjust or a discretionary power must administer the trust or estate impartially based on what is fair and reasonable to all beneficiaries. He must favor one or more beneficiaries if and to the extent the trust or will clearly shows that he can or must do so. The CPIA presumes that a determination in accordance with its provisions is fair and reasonable to all.

The CPIA allows a trustee to adjust the funds he receives between principal and income under certain circumstances: he must manage the trust's assets as a prudent investor (investing for total return as provided in the Prudent Investor Act), follow the trust's terms and the CPIA's allocation rules, and believe he cannot produce a fair and reasonable result for all beneficiaries without making an adjustment.

Trustees must consider all the factors relevant to the trust and its beneficiaries in deciding whether and to what extent to adjust between principal and income. These factors include the:

1. trust's nature, purpose, and expected duration;
2. settlor's intent;
3. beneficiaries' identity and circumstances;
4. needs for liquidity, regular income, and capital preservation and appreciation;
5. assets held in the trust, the extent to which assets are financial, interests in closely held enterprises, or tangible and intangible

property, the extent to which a beneficiary uses assets, and whether an asset was purchased by the trustee or received from the settlor;

6. net amount allocated to income under the rules of the CPIA and the trustee's estimated change in value for principal assets that do not have readily available market values;
7. extent to which the trust's terms prohibit or grant the power to invade principal or accumulate income and the extent to which the trustee has exercised that power;
8. actual and anticipated effect of economic conditions on principal and income and the effects of inflation and deflation; and
9. anticipated tax consequences of an adjustment.

COMMITTEE ACTION

Judiciary Committee

Joint Favorable Substitute

Yea 35 Nay 0